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IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-153

COMMERCIAL UNION ASSURANCE CO., PLC, COMMERCIAL UNION PENSIONS MANAGEMENT, LTD., GEMINI OVERSEAS CORPORATION, MERCIA ZURICH, A.G., OVERBROOK NOMINEES, LTD. and STRAND NOMINEES, LTD.,

Petitioners,

—against—

MICHAEL R. MILKEN and LOWELL J. MILKEN,

Respondents.

REPLY BRIEF FOR PETITIONERS

The Milkens' opposing brief demonstrates in a compelling fashion the need for review by this Court at this time of the issues presented. The standing, injury and judgment reduction rules established by the Second Circuit are misconceived and represent a serious hindrance to the administration of the federal securities acts and the Racketeer Influenced and Corrupt Organizations Act ("RICO"). Plenary review is needed to promote clarity, consistency and coherence for those who rely upon, or are subject to liability under, the securities acts and RICO, and to effectuate Congress' directives in enacting those statutes. Because the Second Circuit's decision squarely conflicts with this Court's and other circuits' precedent, certiorari should be granted to resolve that conflict and otherwise bring about a

long-overdue uniformity in the law relating to these important, recurring federal statutory issues.[1]

I. CERTIORARI SHOULD BE GRANTED TO REVIEW THE SECOND CIRCUIT'S AMORPHOUS AND UNFOUNDED RICO SPECIAL INJURY REQUIREMENT.

This Court has rejected all special injury restrictions on standing under RICO, declining to go beyond the statute's plain meaning and imply special proof requirements peculiar to RICO. *See, e.g., Sedima, S.P.R.L.* v. *Imrex Co.*, 473 U.S. 479 (1985); *American National Bank & Trust Company of Chicago* v. *Haroco, Inc.*, 473 U.S. 606 (1985); *Bankers Trust Co.* v. *Rhoades*, 473 U.S. 922 (1985). By interpreting civil RICO as requiring something more than injury from the predicate offenses, *i.e.*, "unrecoverable" loss, the Second Circuit clearly has adopted a variant of the special injury standing requirement long discredited by this Court.

The Milkens contend that "*Sedima* has nothing to do with this case", because "petitioners suffered *no* injury in their business or property". (Opp. Br. 12, emphasis in original).[2] In March 1986, petitioners acquired interests in a limited partnership in reliance on fraudulent offering materials; their injury is the actual purchase of those partnership interests.[3]

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[1] The Milkens' opposing brief seeks to interject a host of extraneous matters, many of which are misleadingly or inaccurately presented. Because these matters concern discovery disputes, the Global Settlement and rulings on which petitioners do not seek certiorari, they have no relevance here. Petitioners will not burden the Court with a discussion of these irrelevant points.

[2] "Opp. Br." refers to Respondent's Brief in Opposition, dated August 17, 1994. "A ___" refers to the Appendix filed with the Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit, dated July 18, 1994.

[3] The Milkens suggest that investors in high-risk investments can *never* suffer injury in their business or property. (Opp. Br. 2, 12).

(footnote continued on next page)

Petitioners were deprived for *four years* of the $10.5 million they invested in the Boesky partnership due to the Milkens' fraud.[4] There is no question that this constitutes injury of the type contemplated by Section 1964(c). *See, e.g., Fleischhauer* v. *Feltner*, 879 F.2d 1290, 1299-1301 (6th Cir. 1989), *cert. denied*, 493 U.S. 1074 (1990), *cert. denied*, 494 U.S. 1027 (1990) (measuring RICO damages by the amount invested as a result of fraud, subject to trebling).[5]

The Milkens acknowledge that petitioners suffered injury "at the moment they purchased their Boesky Partnership interests". (Opp. Br. 13). Because that injury was mitigated in litigation *four years* later, it was deemed "nonexistent" *ab initio* by operation of the special injury restriction. (Opp. Br. 13). That special injury restriction suffers from the same

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That is nonsense. Petitioners' acceptance of ordinary business risks when they made their investments hardly means that they assumed the undisclosed risk that the partnership would be managed by a criminal whose reputation as a highly skilled and successful arbitrageur depended on his illegal securities arrangements with the Milkens. Boilerplate disclaimers in offering documents are ineffective in the face of such affirmative misstatements and omissions.

[4] Petitioners recovered from defendants in this case (other than the Milkens) an amount equivalent to prejudgment interest at the rate of approximately 3.8% for each of the four years in which they were out-of-pocket their investment capital due to the Milkens' fraud. Although the Milkens labor to characterize this as "profit" (Opp. Br. i, 3-4, 5, 7, 9-15), "prejudgment interest is an element of [petitioners'] complete compensation." *Osterneck* v. *Ernst & Whinney*, 489 U.S. 169, 175 (1989) (internal quotation marks and citation omitted).

[5] The Milkens cite *Fleischhauer* and three other cases for the proposition that "fully recouped investors" are not injured in their business or property within the meaning of Section 1964(c). (Opp. Br. 16). The cases do not stand for that principle. The court in each case held only that expectancy damages were not recoverable under RICO *on the facts presented.*

defects as those rejected in *Sedima*, *American National Bank*, and *Bankers Trust*.

Not only is there no room in the RICO statutory language for the Second Circuit's special injury concept, but the difficulty in discerning just what an allegedly "unrecoverable" loss consists of makes that concept impossible to apply in practice. The compelled wait to determine whether a RICO plaintiff's losses are "unrecoverable" will necessarily lead to the "pursuit of stale claims, complex statute of limitations problems, or the wasteful splitting of actions, with resultant claim and issue preclusion complications." *Sedima*, 473 U.S. at 490 n.9.

The Milkens contend that "nothing in the court of appeals' decision here imposes a general requirement that RICO plaintiffs exhaust all available sources of collection before they may assert a treble-damages claim." (Opp. Br. 14, internal quotation marks and citation omitted). Although the Milkens argue that the Second Circuit's resurrection of the special injury restriction is confined to this case (Opp. Br. 11), the opinion gives no obvious indication that it is so limited. To the contrary, this decision is only one episode in a recent proliferation of Second Circuit RICO dismissals where potential sources of recovery remain at least hypothetically available to the plaintiff. *See First Nationwide Bank* v. *Gelt Funding Corp.*, 1994 U.S. App. LEXIS 14436 (2d Cir. June 9, 1994) (citing this decision); *Stochastic Decisions, Inc.* v. *DiDomenico*, 995 F.2d 1158 (2d Cir.), *cert. denied*, 114 S. Ct. 385 (1993). Thus, the court that decided this case apparently would not agree with the Milkens that its holding is confined to the facts presented.

Selective application of the RICO special injury requirement on a case-by-case basis in and of itself raises significant issues justifying the grant of certiorari. "Congress did not intend § 1964's availability to turn on the victim's specific situation or conduct. Rather, the statute is aimed at a defendant's conduct." *Bankers Trust Co.* v. *Rhoades*, 741 F.2d 511, 522 n.1 (2d Cir. 1984) (Cardamone, J., dissenting),

vacated and remanded, 473 U.S. 922 (1985). No circumstances can justify the "unwarranted and counterproductive exercise [of] litigat[ing] a series of exceptions" to Section 1964(c), which would leave the intent and meaning of that statute in a state of hopeless confusion. *Kansas* v. *Utilicorp United Inc.*, 497 U.S. 199, 216-17 (1990) (declining to carve out exceptions to the antitrust direct purchaser rule).

II. CERTIORARI SHOULD BE GRANTED TO REVIEW THE IMPORTANT ISSUE OF RICO JUDGMENT REDUCTION.

A. A Uniform Reduction Approach Is Needed.

Although no doubt unintended, the Milkens' opposing brief convincingly demonstrates the importance of a uniform RICO judgment reduction rule. Forsaking the "clarity and predictability in RICO's civil applications [that] are particularly important" in administering the statute, *H.J. Inc.* v. *Northwestern Bell Telephone Co.*, 492 U.S. 229, 255 (1989) (Scalia, J., concurring), the Second Circuit has applied a case-by-case approach in which different reduction rules are used in different factual contexts.

The difficulty in administering the Second Circuit's factbound, *ad hoc* approach is illustrated by this case. The Court of Appeals was required to resolve disputed fact issues, left undecided by the District Court, to determine whether the January 1990 payments constituted a settlement, restitution or recoupment.[6] That factual determination will now need to be made in every Second Circuit RICO action where the

[6] It is not an appellate court's role to find facts. *See, e.g., Icicle Seafoods, Inc.* v. *Worthington*, 475 U.S. 709, 714 (1986). Further, the evidence on which the Second Circuit made its factual determination was neither "unambiguous" nor "undisputed" as the Milkens claim. (Opp. Br. 4, 6). The affidavit of the partnership's liquidating trustee, on which the Second Circuit relied, was intended only to confirm the dollar amounts of petitioners' recoveries; it was

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plaintiff has obtained prejudgment recoveries. Already overburdened trial courts will be deluged with collateral litigation to classify the plaintiff's recoveries, while litigants' rights will come to "turn on clever draftsmanship". *Simpson* v. *Union Oil Co. of California,* 377 U.S. 13, 24 (1964) (discussing the Sherman Act). The difficulty of the task, compounded by the opinion's failure to precisely formulate how to distinguish among different recoveries, cautions strongly against the Second Circuit's judgment reduction approach.[7]

The Seventh Circuit and district courts in other circuits have rejected the *ad hoc* approach, applying instead a uniform judgment reduction rule that trebles the jury award before offsetting pretrial recoveries, regardless of their source, nature

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not prepared in connection with the summary judgment motion or even with reference to that motion. The liquidating trustee was not asked, nor did he address in his affidavit, whether the January 1990 payments were pursuant to a settlement. In any event, the same reduction rule should apply to all prejudgment recoveries regardless of their classification as a settlement, restitution, recoupment or otherwise.

[7] The RICO plaintiff's recovery of his own property is yet another factor that requires collateral litigation incident to rule selection. Here, the Milkens claim petitioners got "their own money" back. (Opp. Br. 15, 18). That statement is incorrect under Delaware law, which governs petitioners as limited partners in a Delaware partnership. The partnership in which petitioners invested is a "distinct legal entity which is separate from its partners." *Hart Holding Company. Inc.* v. *Drexel Burnham Lambert Inc.*, [1992 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 74,333 at 77,482 (Del. Ch. Nov. 7, 1991). A partner's statutory tenancy interest in partnership property gives him no individually exercisable rights over that property. 6 *Del. C.* § 1525. Because petitioners had no legal right to possess the partnership's assets and no direct claim to those assets, they could not as a matter of law get back their own money in January 1990.

or timing.[8] (Pet. 16-17). Under this approach, the civil RICO plaintiff achieves complete treble-damages recovery and the RICO offender does not escape liability through the adventitious actions of others. By contrast, the Second Circuit's approach makes single damages possible under Section 1964(c), thereby defeating RICO's compensatory and deterrent goals.

The Milkens provide the best evidence that the Second Circuit's judgment reduction rule seriously impairs RICO's deterrent purposes. The Milkens have invoked that rule to proclaim that petitioners "are not victims at all". (Opp. Br. 18). This unprincipled statement comes from Michael Milken, a convicted felon characterized by the Second Circuit as "the leading disciple of the theory that sheer greed is what drives our national securities markets", who, in a "display of avarice . . . plainly thought of money and of his own gain first, leaving integrity and his clients' interests a distant second." *In re The Drexel Burnham Lambert Group, Inc.*, 995 F.2d 1138, 1141 (2d Cir. 1993). The Second Circuit's opinion, which operates to let the Milkens and other obvious offenders escape accountability under RICO,[9] pulls the teeth from the statute, reducing its effectiveness nearly to zero.

B. The RICO Judgment Reduction Rule Must Preserve The Statutory Entitlement To Attorney's Fees.

The Milkens claim that petitioners "do not qualify" for a Section 1964(c) attorney's fee award because they have not sustained a special RICO injury. (Opp. Br. 18-19). This

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[8] By forcing a RICO victim to choose between foreswearing restitution and forfeiting treble damages to obtain it, the Second Circuit is in direct conflict with the Seventh Circuit. *See Mosler* v. *S/P Enters., Inc.*, 888 F.2d 1138, 1144 (7th Cir. 1989); *Carter* v. *Berger*, 717 F.2d 1173, 1175-76 (7th Cir. 1985).

[9] The Milkens' representation that the felonies to which Michael Milken pleaded guilty are "unrelated to petitioners' securities purchases" is a transparent revision of the complaint, which is based in substantial part on respondent's guilty plea. (Opp. Br. 7).

Court's rejection of all special injury restrictions completely forecloses that argument.

Petitioners' entitlement to a RICO fee award is fully supported by the Second Circuit's finding that petitioners' "causes of action might well subject defendants to liability". (A11). At each stage of the litigation, from complaint through appeal, petitioners have asserted their right to recover the full measure of damages available under RICO, as well as under the securities acts and the common law. The statutory fee award is an integral part of the relief sought by petitioners and every other civil RICO plaintiff. Certiorari should be granted to consider whether a RICO plaintiff's prejudgment recoveries exonerate nonsettling RICO defendants from liability for statutory costs and attorney's fees.

III. CERTIORARI SHOULD BE GRANTED TO REVIEW THE IMPORTANT ISSUE OF JUDGMENT REDUCTION IN FEDERAL SECURITIES LITIGATION.

The Milkens contend, without citation to supporting authority, that Section 28(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78bb(a), strictly limits a defrauded investor's recovery under the securities laws to actual damages and, hence, is inconsistent with the proportionate fault approach. (Opp. Br. 20). To the contrary, Section 28(a) does not "enshrine" the "one satisfaction rule" (Opp. Br. 20), or otherwise preclude application of the proportionate fault approach in federal securities litigation.

"[T]his Court has never interpreted § 28(a) as imposing a rigid requirement that every recovery on an express or implied right of action under the 1934 Act must be limited to the net economic harm suffered by the plaintiff." *Randall* v. *Loftsgaarden*, 478 U.S. 647, 663 (1986). *See also Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 155 (1972).

> . . . Congress' aim in enacting the 1934 Act was not confined solely to compensating defrauded investors. Congress intended to deter fraud and

> manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions. This deterrent purpose is ill served by a too rigid insistence on limiting plaintiffs to recovery of their "net economic loss."

Randall, 478 U.S. at 664 (citation omitted). The mere fact that the receipt of prejudgment recoveries may place a plaintiff in a better position than he would have been in absent the fraud "does not establish that the flexible limits of § 28(a) have been exceeded." *Id.* at 663. It "is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." *Id.* (internal quotation marks and citation omitted). *See also McDermott, Inc.* v. *AmClyde*, 114 S.Ct. 1461, 1470-71 (1994).[10]

McDermott rightly calls into question the continuing viability of the *pro tanto* rule adopted by the Second Circuit in *Singer* v. *Olympia Brewing Co.*, 878 F.2d 596, 599 (2d Cir. 1989), *cert. denied*, 493 U.S. 1024 (1990).[11] Judge Cardamone, who wrote the decision below, acknowledged only last month in another securities case, *Bragger* v. *Trinity Capital Enterprise Corp.*, 1994 U.S. App. LEXIS 17483 (2d Cir. July 15, 1994), that

> it would seem unwise in the present instance to leave standing the district court ruling that any judgment against appellant be reduced on a pro tanto basis. We think it imprudent in light of a

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[10] The one satisfaction rule prohibits the plaintiff from unjustly enriching himself at the expense of the defendants. That principle would not be violated here because the Milkens, as nonsettling defendants, will still not be required to pay more than their apportioned shares. *See Franklin* v. *Kaypro Corp.*, 884 F.2d 1222, 1231-32 (9th Cir. 1989), *cert. denied*, 498 U.S. 890 (1990).

[11] Nothing in *McDermott* limits its application to settlements or suggests that different judgment reduction rules apply depending on the classification of prejudgment recoveries. The Milkens' argument that *McDermott*'s proportionate fault approach is limited to "settlements" is fatally inconsistent with their position that *Singer*'s *pro tanto* approach applies to all forms of recovery. (Opp. Br. 19-20).

> recent unanimous decision of the Supreme Court [in *McDermott*] holding, after thorough analysis of the pro tanto and proportional judgment reduction methods, that at least in admiralty suits for damages, the proportional reduction approach is best.

Id. at *11.

Although the Milkens labor to contend otherwise, there can be no doubt that a considerable number of actions in the lower courts will turn on the resolution of this issue. A definitive ruling by the Court is thus desirable "to promote clarity, consistency and coherence for those who rely upon or are subject to" liability under the securities acts and "to effect Congress' objectives in enacting the securities laws". *Musick, Peeler & Garrett* v. *Employers Ins. of Wausau*, 113 S. Ct. 2085, 2090 (1993) (citations omitted). Proportionate fault is the approach most "symmetrical and consistent" with the federal securities acts and, as such, is the correct judgment reduction rule. *Id.* The instant case presents the appropriate vehicle by which to make this clear to the many federal courts confronting the issue on a daily basis.

CONCLUSION

For the foregoing reasons, the petition for a writ certiorari should be granted.

Dated: August 23, 1994

Respectfully submitted,

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